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Before the
FEDERAL COMMUNICATION COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board	)	(Report to Congress)
on Universal Service	)	

Reply Comments of the
Ad Hoc Telecommunications
Users Committee

The Ad Hoc Telecommunications Users Committee (Ad Hoc) hereby replies to certain arguments made in response to the Common Carrier Bureau's solicitation of public comment to be considered in the formulation of a report that the Commission must submit to Congress pursuant to the 1998 appropriations legislation for the Departments of Commerce, Justice and State.[1]

Numerous parties contend that the Commission should allow carriers great flexibility with respect to the means that they use to collect their universal service fund (USF) contributions, and that clear identification of universal service is required by the Telecommunications Act of 1996.[2] Ad Hoc agrees that the Commission should allow carriers to specifically identify USF-related charges. Clear identification of such charges would aid the transition to economically rational rate structures. Certainly, the Commission should not

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1 *Federal State Joint Board on Universal Service*, CC Docket No. 96-45, Public Notice, DA 98-2, Jan. 5, 1998 ("Report to Congress").

2 *See e.g.*, Comments of AT&T on Report to Congress, at 4-5 ("AT&T Comments"), Comments of AirTouch Communications, Inc. on Report to Congress, at 23-27.

discourage carriers from identifying such charges, and would not argue with the proposition that consumers have a right to know what they are paying for.

Ad Hoc, however, strongly objects to carriers being allowed to unilaterally reform existing service contracts to recover USF contribution charges. Ad Hoc has pending before the Commission a petition seeking partial reconsideration and clarification of the Commission's May 8, 1997 Report and Order in this docket. Therein Ad Hoc urges the Commission to reconsider, among other things, paragraph 851 of the May 8, 1997 Report and Order. In paragraph 851, the Commission suggested that it would allow carriers to abrogate unilaterally their contracts with customers to recover new universal service obligations. Ad Hoc has explained that paragraph 851 is inconsistent with state contract law, the Commission's substantial cause doctrine, and with fundamental fairness. Neither state contract law nor the Commission's substantial cause doctrine allows carriers or other parties to contracts to unilaterally reform their contractual obligations simply because a governmental order may render contract performance less profitable. Moreover, Ad Hoc pointed out that the net effect of the *Universal Service*, *Access Charge Reform* and *Price Caps* orders, all adopted on May 7, 1997, probably is a reduction in the carriers' cost of serving large customers.[3] Paragraph 851, however, makes no reference to the net effect of these three orders. By not considering the net

[3] *Federal State Joint Board on Universal Service*, CC Docket No. 96-45 ("*Universal Service*"), Report and Order, 12 FCC Rcd 8776 (rel. May 8, 1997) ("Order"), *partial recon.* Fourth Order on Reconsideration in CC Docket No. 96-45, Report and Order in CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, FCC No. 97-420 (rel. Dec. 30, 1997) ("Fourth Order").

effect of the three orders, and if it now refuses to acknowledge the net effect of the three orders on carriers' cost of serving large customers, the Commission has acted, and could again act, arbitrarily and capriciously, and certainly unfairly. Attachment A hereto is the Petition of the Ad Hoc Telecommunications Users Committee for Partial Reconsideration and Clarification of Report and Order in this docket. This petition sets forth the foregoing argument in detail. For all of the reasons set forth in Attachment A, carriers should not be allowed to abrogate unilaterally their existing service contracts because one element of their cost structure increases, particularly when other cost structure elements decrease.

Ad Hoc also takes issue with the contention of some parties that the Commission erred in holding that systems integrators who obtain a *de minimus* amount of their revenues from the resale of telecommunications need not contribute directly to the USF.[4] The Commission reached this decision after careful consideration of a substantial record. The parties who argue that the Commission erred on this matter provide no new facts or analysis; they rely instead on mere conclusory assertions. AT&T contends that the exemption for system integrators' resale telecommunications revenues, "could exempt substantial amounts of retail telecommunications revenues from USF contributions." IBM, however, demonstrated that including system integrator revenues in the universal service contribution base would reduce the per

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[4] *See, e.g.*, AT&T Comments at 6-8; Comments of United States Telephone Association, at 5-6.

provider contribution percentage by less than 1/100th of a percent, truly a *de minimus* amount.[5] AT&T also asserts that the systems integrator exemption, "will open up possibilities for gaming the process if telecommunications providers drive their major customers into numerous system integration subsidiaries."[6] The Commission, however, found that systems integrators and telecommunications service providers do not provide the same services and do not serve the same markets.[7] The Commission also set a very low limit on the amount of telecommunications service that systems integrators could resell and still avoid the obligation to make direct USF contributions.[8] Finally, AT&T provides nothing other than speculation, indeed, undeveloped speculation, to support its gaming assertion. All of that being the case, AT&T's gaming argument must be found baseless.

The commenters provide no basis for Commission reconsideration of the relevant portion (paragraphs 267-282) of the *Fourth Order*.

In view of the foregoing, the Commission should not consider reversing its decision to exempt systems integrators from direct universal service contributions and should not allow carriers to abrogate their existing

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5 *Universal Service*, Comments of International Business Machines Corporation in Support of Petition for Reconsideration, at 12-13 (Aug. 18, 1997). IBM's comments are Attachment B hereto.

6 AT&T Comments, at 6.

7 Fourth Order, ¶¶ 278-79.

8 *Id.*, at ¶ 280.

service contracts with their end users to collect universal service contributions absent a demonstration that it would be commercial impracticability to continue service under those contracts. The Commission, however, should encourage, not discourage, carriers to identify clearly as a separate line item on their bills that portion of the bill that is attributable to universal service programs.

Respectfully submitted,

Ad Hoc Telecommunications
Users Committee

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200.03/usf/reply rpt to congress

Certificate of Service

I, Andrew Baer, hereby certify that true and correct copies of the preceding Reply Comments of the Ad Hoc Telecommunications Users Committee in CC Docket Number 96-45 (Report to Congress) were served this 6th day of January, 1998 via hand delivery to the following parties.

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February 6, 1998

200.03/usf/CRT SRV Reply Report to Congress

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In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on Universal Service	)	

PETITION OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE
FOR PARTIAL RECONSIDERATION AND CLARIFICATION
OF REPORT AND ORDER

Pursuant to Section 1.429 of the Commission's Rules, 47 C.F.R. § 1.429, the Ad Hoc Telecommunications Users Committee (the "Ad Hoc Committee") petitions for partial reconsideration and clarification of the Report and Order ("R & O") in the captioned proceeding.[1] For the reasons set forth below, the Commission should reconsider and clarify the indicated portions of the R & O in the following manner:

1. First, the Commission should recant its statement in Paragraph 851 of the R & O that carriers may unilaterally abrogate customer contracts to raise the rates provided for in those contracts to reflect the carriers' newly required contributions to the universal service support mechanisms; the Commission should either re-affirm that carriers will not be relieved of their contractual commitments by virtue of the R & O or, if it allows carriers to reform the terms of their customer contracts, it should also allow customers to

[1] *Federal-State Joint Board on Universal Service*, Report and Order, CC Dkt. No. 96-45, FCC 97-157 (released May 8, 1997). Notice of the R & O was published in the *Federal Register* on June 17,1997, 62 Fed. Reg. 32862. Accordingly, this Petition is timely filed pursuant to Sections 1.429(d) and 1.4(b) of the Commission's Rules, 47 C.F.R. §§ 1.429(d), 1.4(b).

terminate their service agreements without termination liability (*i.e.*, to take a "fresh look").

2. Second, the Commission should reverse its decision to require private carriers to contribute to the universal service support mechanisms to the extent that systems integrators will be required to make contributions and should reconsider its default definition of the *de minimis* exception.

3. Third, the Commission should clarify its decision regarding the obligations of payphone service providers and payphone aggregators and it should specifically clarify that entities that do not provide telecommunications, including many aggregators and some payphone service providers, will not be required to contribute to universal service support mechanisms.

The Ad Hoc Committee's members are large purchasers of telecommunications services and products from carriers and systems integrators. Certain members of the Ad Hoc Committee are also payphone aggregators. The portions of the R & O of which the Ad Hoc Committee seeks reconsideration will adversely affect some or all of the Committee's members in varying degrees.

I. THE FCC SHOULD RECONSIDER ITS DECISION IN PARAGRAPH 851 TO ALLOW CARRIERS TO REFORM OR RESCIND THEIR CONTRACTS WITH CUSTOMERS TO RAISE THEIR RATES IN PROPORTION TO THEIR UNIVERSAL SERVICE CONTRIBUTION OBLIGATIONS.

The Commission should reconsider its decision in Paragraph 851 of the R & O to allow carriers to unilaterally abrogate their contracts with customers so as to raise their rates in proportion to their new universal service obligations for the following two reasons. First, the Commission's R & O contradicts basic principles of state contract law, the Commission's own precedent, and

fundamental fairness. Second, the Commission has not considered that the net effect of the three orders adopted on May 7, 1997, may be that the cost of serving large users of telecommunications services will decrease. Nor has the Commission allowed large users to take a "fresh look" at their contractual arrangements with carriers in light of the universal service decision.

A. State Contract Law Does Not Permit Unilateral Rescission or Reformation of Contractual Obligations in Response to Governmental Regulation.

The Commission's decision to allow carriers to reform their customers' contracts is based on the assumption that the carriers did not foresee the new universal service contribution requirements, which have increased the carriers' costs of providing service.[2] But, even if this assumption is correct—and it is not—it is not a valid basis for allowing carriers to reform their customer contracts unilaterally to raise their rates.

Basic state contract law generally conflicts with the Commission's decision in Paragraph 851, despite the Commission's assurances that the R & O "is not intended to preempt state contract laws."[3] State contract law does not authorize carriers or other parties to contracts to unilaterally rescind or reform their contractual obligations simply because a governmental order may render contract performance less profitable.

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[2] The Commission asserted that it "create[d] an expense or cost of doing business that was not anticipated at the time contracts were signed." R & O at ¶ 851.

[3] *Id.*

New York State contract law, for example,[4] maintains that an individual party "may not abrogate a contract unilaterally merely by showing it would be financially disadvantageous to perform it."[5] This general rule has been consistently applied where the government renders performance of a contract less profitable.[6] If a governmental action is foreseeable at the time parties assume their contractual obligations, then unilateral abrogation by either party will be impermissible, even if one of the contracting parties becomes bankrupt as a result of being required to perform its obligations.[7] If something -- including a

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[4] The Ad Hoc Committee has focused on one state to illustrate its argument. Because of the long history and high level of commercial activity in New York, we have analyzed the soundness of the Commission's abrogation conclusion under New York State law. Other states, however, follow the general rule that applies in New York. *See, e.g., Cutter Laboratories, Inc. v. Twining,* 34 Cal.Rptr. 317, 324 (Dist. Ct. App. 1963); *Standard Iron Works v. Globe Jewelry & Loan, Inc.,* 167 C.A.2d 108, 118; 330 P.2d 271 (Dist. Ct. App. 1958); *Rose v. Long,* 128 C.A.2d 824, 827; 275 P.2d 925 (Dist. Ct. App. 1954); *Consolidated Laboratories Inc. v. Shandon Scientific Co.,* 413 F.2d 208, 212 (7th Cir. 1969) (applying Illinois law); *Valtrol Inc. v. General Contractors Corp.,* 884 F.2d 149, 153-154 (4th Cir. 1989) (applying Texas law); *Measday v. Kwik Kopy Corp.,* 713 F.2d 118, 126 (5th Cir. 1983) (applying Texas law).

[5] *A.W. Fiur Co. v. Ataka and Co.,* 422 N.Y.S.2d 419, 423 (A.D. 1979); *see also 407 E. 61st Garage, Inc. v. Savoy 5th Ave. Corp.,* 23 N.Y.2d 275, 282 (1968); *Rockwell v. Knights Templars & Masonic Mut. Aid Assn.,* 119 N.Y.S. 515, 518-519 (A.D. 1909) ("[i]t is repugnant to the idea of a contract that one of the parties may, at his election, from time to time change the amounts which he is to receive from the other party. . . . The fact that a contract proves unprofitable...is no reason why the courts can permit the party who has made such an unwise contract to change its terms at will and make for itself a more profitable contract.").

[6] *Coastal Power Production Co. v. New York State Public Service Commission,* 551 N.Y.S.2d 354, 356 (A.D. 1990) ("'[t]he fact that a contract becomes increasingly difficult and expensive to perform because of a law enacted after its execution does not excuse performance'") (quoting 22 NYJur2d, Contracts, § 355). *See Sullivan County Harness Racing Assn. v. City of Schenectady Off-Track Betting Commission,* 351 N.Y.S.2d 56, 60 (Sup. Ct. 1973) ("performance is *never* excused by changes in the law, particularly when the law was in existence when the contract was made and the changes were foreseeable") (emphasis added). *See also Reetz, Inc. v. Stackler,* 201 N.Y.S.2d 54, 57 (Sup. Ct. 1960).

[7] *A&S Transportation Co. v. County of Nassau,* 546 N.Y.S.2d 109, 111 (A.D. 1989) ("when a governmental action is foreseeable, a contractor may not invoke "impossibility" to excuse performance"). *Stasyszyn v. Sutton East Associates,*555 N.Y.S.2d 297, 299 (A.D. 1990) ("the law is well-established that economic inability to perform contractual obligations, even to the extent of insolvency or bankruptcy, is simply not a valid basis for excusing compliance"). *See also 407 E. 61st Garage, Inc. v. Savoy 5th Ave. Corp.,* 23 N.Y.2d 275, 281-82 (1968).

governmental order -- is unforeseeable at the time parties enter into a contract, performance will be "excused only in extreme circumstances,"[8] *i.e.*, the order renders performance of the contract impossible or illegal.[9]

The effects of the *Universal Service* R & O were foreseeable; therefore, under New York State contract law, carriers would not be excused from their contractual obligations to customers, even if performance of those obligations would drive the carriers into bankruptcy. But, even assuming, *arguendo,* that carriers' universal service contribution obligations were unforeseeable, the modest financial impact of those obligations on the carriers[10] would not amount to an "extreme circumstance" warranting contract reformation under New York law.

Thus, whether or not the imposition of universal service support obligations was foreseeable, in neither event would New York State law permit carriers unilaterally to reform and rescind their contractual obligations to customers to raise their rates in proportion to their universal service obligations.

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8 *Kel Kim Corp. v. Central Markets Inc.*, 524 N.Y.S.2d 384, 385 (N.Y. 1987); *see also J.J. Casone Bakery, Inc. v. Edison Co. of New York*, 638 N.Y.S.2d 898 (Sup. Ct. 1996).

9 *See Flaster v. Seaboard Garage Corp.*, 61 N.Y.S.2d 152, 155 (Sup. Ct. 1946); *Doherty v. Monroe Eckstein Brewing Co*, 187 N.Y.S. 633, 635 (Sup. Ct. 1921).

10 *See* Section I.E., below, for a discussion of the economic impact of the *Universal Service* R & O as well as the *Price Caps* and *Access Charge Reform* Orders.

Because the Commission stated that it does not intend to preempt state law in this area,[11] its action in paragraph 851 would have no effect in any state that follows the New York rule.[12]

B. The New Carrier Universal Service Obligations Were Foreseeable.

The Commission's assumption that carriers subject to new or increased universal service contribution obligations did not foresee them is beside the point, not to mention speculative and unsupported by the record. Telecommunications carriers, like other regulated and even unregulated businesses, price their services to reflect the risk of unforeseen cost increases, which occur regularly. Vendors should not be relieved from the contractual risks they assume for cost *increases* unless their customers can adjust contract price terms to take advantage of vendor's cost *decreases.*

The advent of changes to the universal service program was foreseeable to all major players, especially carriers, within the telecommunications industry. The industry has been regulated for over 60 years; thus, carriers' rates and rate-related terms have long been affected by regulatory actions. Moreover, the universal service program in particular is part of a comprehensive regulatory framework, which can be adjusted when appropriate.[13]

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[11] R & O at ¶ 851.

[12] The existence of different state laws in this area would make it administratively difficult to implement Paragraph 851 as presently drafted.

[13] *See* 47 U.S.C. §§ 254(a)(i), 254(c)(2); *cf. Policy and Rules Concerning Rates for Dominant Carriers,* 3 FCC Rcd 3195, 3200 (1988) (the telecommunications industry is changing rapidly and policies must be flexible enough to adjust to those changes); *MTS and WATS Market Structure -- Amendment of Part 67 (New Part 36) of the Commission's Rules,* 3 FCC Rcd 5518, 5529 (1988) (granting NECA petition to resize the universal service fund).

And the passage and implementation of the Telecommunications Act of 1996 (the "1996 Act") evolved over the past 3-4 years. The legislation that was eventually enacted as the 1996 Act took over two years to become law[14] and the implementation of Section 254 has lasted 15 months.[15] For these reasons, carriers cannot claim that they did not contemplate an increase—or at least a change—in the universal service obligations when they entered into contractual relationships with their customers.

Using the rationale the Commission has employed in Paragraph 851, any time the cost of providing service decreases for some carriers—even unforeseeably—their customers should be permitted to lower their rates unilaterally in proportion to the decrease. Yet the Commission has ignored customer interests by allowing only carriers to amend contracts unilaterally if the carriers' costs increase, not when they decrease. In short, the Commission has inconsistently applied its "unforeseeability" reasoning to customers and carriers;[16] therefore that rationale does not furnish a legitimate basis for permitting carriers to abrogate their service contracts.

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[14] In the June of 1994, the House of Representatives overwhelmingly passed two bills—the Antitrust Communications Reform Act (H.R. 3626) and the Communications Competition and Information Infrastructure Reform Act (H.R. 3636)—after extensive hearings throughout 1993 and early 1994. Similarly, the Senate passed the Communications Act of 1994 (S. 1822) in August of 1994. All three pieces of legislation were precursors to the 1996 Act. Knauer, Machtley, Lynch. *Telecommunications Handbook: A Complete Reference for Business.* Chapter 1: Legislative History of the Telecommunications Act of 1996. (Government Institutes, 1996).

[15] *See Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (released March 8, 1996) ("NPRM").

[16] The filed tariff (or "filed rate") doctrine already renders customers captive to the tariff filing caprice of the carriers from whom they purchase tariffed services. The implementation of Paragraph 851 will only compound the imbalance in carrier/customer relationships, shackle

C. FCC Precedent Permits Unilateral Abrogation of Carriers' Contractual Obligations in Extreme Circumstances Only.

The Commission's own precedent does not permit a carrier to unilaterally abrogate a service contract to raise the rates provided under contract unless highly unusual and unforeseeable circumstances warrant reformation, and only if the carrier demonstrates "substantial cause" for increasing its rates.[17]

Beyond the Commission's somewhat vague reference to the "public interest" in Paragraph 851,[18] there has been no demonstration in this docket of cause (must less "substantial cause") for allowing carriers to revise the terms of their customer contracts for the purposes of raising their rates. Assuming that the Commission's conclusory reference to the "public interest" was an indication that the Commission is concerned about the financial impact of the *Universal Service* R & O on affected carriers, such a concern is misplaced.[19] As

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customers further, and erode their confidence in the integrity of contracts for tariffed telecommunications services in contravention of the public interest. *See Competition in the Interstate Interexchange Marketplace,* CC Dkt. No. 90-132, Report and Order, 6 FCC Rcd 5880 (1991) at 5899-5901; Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 4562 (1995) (reciting public interest benefits of contract carriage).

[17] *Tariff Filing Requirements for Nondominant Common Carriers*, Order, 10 FCC Rcd 13653 at ¶¶ 12-16 & n.35 (1995); *RCA American Communications, Revisions to Tariff FCC Nos. 1 and 2*, Memorandum Opinion and Order, 84 FCC 2d 353, 358 (1981); 86 FCC 2d 1197, 1201(1981); 2 FCC Rcd 2363 (1987) (collectively, "*RCA Americom* Orders"), *aff'd sub nom. Showtime Networks, Inc., v. FCC*, 932 F.2d 1 (D.C. Cir. 1991); *see AT&T Communications Contract Tariff No. 360*, Order Designating Issues for Investigation, 10 FCC Rcd 11031 at 11032-35 (1995).

[18] The Commission stated, "[w]e find that universal service contributions constitute a sufficient public interest rationale to justify contract adjustments." R & O at ¶ 851.

[19] The Commission cites *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) in apparent support of its invocation of the public interest rationale to permit carriers to reform their service contracts with customers. R & O at note 2132. This authority, however, is inapposite because the so-called "*Sierra-Mobile* doctrine" has traditionally been applied only to carrier-to-carrier contracts, not to carrier-to-customer contracts, which make up the vast majority of telecommunications service contracts.

demonstrated in Section D, below, the net effect of the *Access Reform, Price Caps,* and *Universal Service* Orders may well be cost *reductions* for carriers serving large customers. In such cases, there is no public interest rationale in allowing the carriers to amend their customer contracts unilaterally to raise their rates.

D. The Commission Erred by Not Accounting For the Net Financial Effect of the "Competition Trilogy" Orders.

In Paragraph 851, the Commission makes no reference to the effect of the *Access Charge Reform*[20] or *Price Caps*[21] Orders on the long distance carriers' cost of service. As demonstrated below, these proceedings will have an effect on some carriers' costs at least as profound as the *Universal Service* Report and Order. The net financial impact of the *Access Reform* and *Price Caps* Orders may be a decrease in costs for carriers providing service to some large users, which would offset any modest cost increase dictated by the *Universal Service* R & O. By not accounting for the combined impact and net effect on rates and carrier earnings of these Orders, the Commission acted arbitrarily and capriciously in sanctioning abrogation of the long distance carriers' service contracts.[22]

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20 *Access Charge Reform,* First Report and Order, CC Dkt. No. 96-262, FCC 97-158 (released May 16, 1997).

21 *Price Cap Performance Review for Local Exchange Carriers,* Fourth Report and Order, CC Dkt. No. 94-1 (released May 21, 1997).

22 *See* 5 U.S.C. § 706(2)(A).

To illustrate, consider a hypothetical corporation, not atypical of members of the Ad Hoc Committee, having 100,000 lines and annual usage of 600 million interstate minutes of use. Assume that the annual charges to this corporation for interstate and international service are $50 million. The net effect of the *Universal Service, Access Charge Reform,* and *Price Caps* Orders in this example will, effective January, 1998, be a reduction of **$1.3 million** annually in the costs to the interexchange carrier that provides services to this hypothetical large customer.[23] Given the significant cost *savings* the carrier in this example will realize in connection with its provision of service to the hypothetical customer, it would be patently unfair to allow the carrier to rescind its contract with the customer to increase its rates.

In short, any Commission concerns about unanticipated cost increases in providing telecommunications services should have been tempered by consideration of unanticipated cost decreases resulting from the *Access Reform/Price Caps* Orders. The Commission arbitrarily and capriciously disregarded the effect of these Orders in Paragraph 851, and should therefore reconsider its decision in that Paragraph.

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[23] This figure was calculated based on the following assumptions: (1) the multiline business Subscriber Line Charge will increase $2.00 per month; (2) the multiline business Primary Interexchange Carrier Charge ("PICC") will be $2.75 per line; (3) the universal service surcharge will be 4% of interstate retail revenues; and (4) the Switched Access Terminating Charge will be reduced by $0.011 per minute. Based on these assumptions, the interexchange carrier serving the hypothetical corporate customer would, with respect to this customer only, pay $3.3 million more than the previous year in PICCs; pay $2 million more in universal service contributions; but ***save*** $6.6 million over the previous year in Switched Access Terminating Charge reductions.

II. THE COMMISSION SHOULD RECONSIDER ITS DECISION TO EXTEND UNIVERSAL SERVICE CONTRIBUTION OBLIGATIONS TO SYSTEMS INTEGRATORS.

In Paragraphs 794 - 796 of the R & O, the Commission imposed on private carriers an obligation to contribute to universal service support mechanisms. If implemented, the operational and economic consequences of this decision will be particularly burdensome for systems integrators and their customers, and will not be justified by the size of the contributions that systems integrators as a class would be required make to universal service. And contrary to the Commission's express wishes, imposition of universal service funding obligations would change the manner in which systems integrators operate.[24] For these reasons, the Commission should clarify that systems integrators will not be required to contribute to universal service support mechanisms.

Systems integrators provide integrated packages of services and products, at times for a single periodic (*i.e.,* monthly) charge, that may include the provision of computer capabilities, telecommunications services, remote data processing services, back-office data processing, management of customer relationships with underlying carriers and vendors, provision of telecommunications and computer equipment, equipment maintenance, help desk functions, and other services and products.

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[24] At Paragraph 795 of the R & O, the Commission stated, "[W]e do not want contribution obligations to shape business decisions."

Systems integrators do not by definition provide telecommunications services on a stand-alone basis; thus, it would be costly and administratively difficult on a going-forward basis for them to isolate the portion of their aggregate charges that is attributable to the provision of telecommunications, and then to allocate revenues from telecommunications between inter- and intrastate services, as they would be required to do to calculate their universal service contributions. It would be even more difficult for them to unravel their existing customer relationships.

A. Systems Integrators Should Fall Within the *De Minimis* Exception Contained in Section 254(c) of the Communications Act, But the Commission Should Reconsider Its Interpretation of that Exception.

Universal service contributions will be assessed on the basis of retail interstate telecommunications revenues,[25] but many systems integrators neither charge their customers separately for telecommunications nor allocate telecommunications revenues between interstate and intrastate traffic. As a result, some systems integrators would be required to incur significant costs to separately account for telecommunications services and to allocate revenues from such services between inter- and intrastate traffic.

The costs to systems integrators of complying with universal service funding obligations would far outweigh the minimal contributions to universal service that their payments would make, thereby qualifying systems integrators as a class for the *de minimis* exception of Section 254(d).

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[25] R & O at ¶ 843.

That provision provides that "[t]he Commission may exempt a carrier or class of carriers . . . if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution to . . . universal service [support] would be de minimis."[26]

The Commission has interpreted this provision as excluding from the contribution requirements any service provider whose contributions would be less than the universal service administrator's cost of collecting the provider's contributions.[27] As a general matter, the Commission has also determined that any entity whose contribution would be less than $100 would not be required to contribute, since the Commission assumes that the universal service administrator's cost of collecting from any entity will be at least $100.[28]

The Commission should reconsider that decision. Rather than setting a number based only on the *administrator's* cost of collecting contributions, the Commission should also consider the administrative cost to each *service provider* of complying with the contribution requirement. Very large corporations that provide integrated equipment and service packages to numerous clients will be forced to incur considerable expenses to isolate and allocate their revenues in order to determine their contribution base. Compared to their compliance costs, their contributions to universal service may be insignificant. Thus, the Commission should reconsider its interpretation of the *de minimis* exemption to

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26 47 U.S.C. § 254(d).

27 R & O at ¶ 802.

28 *Id.* at ¶ 803.

account for such entities. But even under the current interpretation, systems integrators should be excused from contributing to universal service support since their contributions will be outweighed by the administrative costs of sizing and collecting those contributions.

B. The Imposition of Universal Service Funding Obligations on Systems Integrators Would be Contrary to the Commission's own Statements in this Proceeding.

In Paragraph 795 of the R & O, the Commission stated that it does "not want contribution obligations to shape business decisions." However, the Commission's decision to require systems integrators to contribute to universal service support mechanisms will achieve exactly the result the Commission has said it seeks to avoid.

Because of the significant changes some systems integrators will have to implement to segregate and monitor their charges to customers for telecommunications and to allocate revenues from such services between the inter- and intrastate jurisdictions, they will almost certainly make new business decisions shaped in part by these new requirements. Indeed, it is possible that some systems integrators will determine that the provision of telecommunications services is simply not worth the added trouble and expense and will cease offering those services altogether. Whether systems integrators merely pass on to their customers the additional costs that they incur or close the doors on their telecommunications business, thus lessening competition in

the market, their customers' business decisions will almost certainly be shaped by the Commission's decision to require systems integrators to contribute to universal service support mechanisms.

In light of the clear inconsistency between the Commission's own statements and the reality of how both both systems integrators and their customers will have to fundamentally change the way they do business in response to the *Universal Service* Order, the Commission should reconsider its requirement that systems integrators contribute to universal service.

C. Imposing Universal Service Contribution Requirements on Systems Integrators Does not Satisfy the Commission's Concerns About Competitive Neutrality, and in Fact Is Contrary to the Commission's Own Stated Purposes in this Docket.

Both the Commission[29] and the Federal-State Joint Board[30] have stated that they designed the universal service contribution system to avoid double counting of revenues. Yet requiring systems integrators to contribute to universal service will involve some degree of double counting.

Underlying carriers will not be required to make universal service contributions based on their sale of services to resellers, because such sales are not to end users; but underlying carriers *will* be required to make universal service contributions based on their sales to end users, including systems integrators.

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29 R & O at ¶ 843.

30 *Federal-State Joint Board on Universal Service*, Recommended Decision of the Joint Board, 12 FCC Rcd 87 (1996) at 495.

Unlike entities that purchase telecommunications services from underlying carriers strictly for resale, many systems integrators purchase telecommunications services for their own internal use and for resale as part of integrated product and service packages. Because it is difficult, if not impossible, to determine what portion of the services systems integrators purchase represents retail sales to end users and what portion represents wholesale services for resale to end users, imposition of universal service contributions on systems integrators would involve double counting for the services they purchase, in contravention of the Commission's and Joint Board's explicit objectives.

And requiring systems integrators to contribute to universal service support can not be justified as furthering the Commission's objective of achieving competitive neutrality between systems integrators (and other private carriers) and common carriers. Systems integrators do not compete with pure telecommunications service providers because the former provide integrated packages of products and services, while the latter provide stand-alone telecommunications services. Therefore, the Commission's "competitive neutrality" concerns in this regard do not furnish a basis for requiring systems integrators to contribute to the universal service program.

Accordingly, the Commission should exclude systems integrators from the contribution requirements.

D. Requiring Systems Integrators to Contribute to Universal Service Support at this Time Would be Beyond the Commission's Authority.

In addition to the above-explained practical and policy considerations, which justify reconsideration of the requirement that systems integrators contribute to universal service support mechanisms, the Commission lacks legal authority to impose such requirements on private carriers and systems integrators. The legislative history of Section 254(d) indicates that Congress did not intend to require non-common carriers to contribute to universal service support mechanisms until such time as bypass of the public switched network became so widespread that the funding base for universal service would have to be expanded to generate sufficient funds to support universal service.

In the Senate Commerce Committee Report on S. 1822, which became the 1996 Act, the Committee wrote:[31]

> In the event that the use of private telecommunications services or networks becomes a significant means of bypassing networks operated by telecommunications carriers, the bill retains the FCC's authority to preserve and advance universal service by requiring all telecommunications providers to contribute.

There is no evidence that "private telecommunications services or networks [have become] a significant means of bypassing networks operated by telecommunications carriers." Notably, the House bill (H.R. 1555), unlike the Senate bill, did not even give the Commission permissive authority to require

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[31] Report of the Senate Committee on Commerce, Science, and Transportation on the *Telecommunications Competition and Deregulation Act of 1995,* S. Rep. No. 104-23, 104th Cong., 1st Sess (March 30, 1995) at 28.

private carriers (including systems integrators) to contribute to universal service support mechanisms.[32]

The Commission failed to consider the legislative history of Section 254 in extending universal service obligations to systems integrators and other private carriers. For this reason, and because no showing has been made of the level of bypass Congress intended to trigger universal service support obligations, the Commission should reconsider its decision to require systems integrators to contribute to universal service support.

III. THE FCC SHOULD RECONSIDER AND CLARIFY ITS DECISION TO EXTEND UNIVERSAL SERVICE CONTRIBUTION OBLIGATIONS TO ALL PAYPHONE "AGGREGATORS."

The R & O concludes that under the Commission's "permissive authority over 'other providers of telecommunications' . . . the public interest requires . . . payphone aggregators to contribute to" universal service support mechanisms.[33] In fact, imposing universal service obligations on aggregators exceeds the Commission's permissive authority under Section 254(d) of the Act and is inconsistent with the public interest concerns the Commission articulated in the R & O. The Commission should therefore reconsider and clarify this aspect of the *Universal Service* R & O.

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[32] *See* Report of the Commerce Committee on H.R. 1555, the *Communications Act of 1995*, H. Rep. No. 104-204 (July 24, 1995), at § 247, pp. 11-12.

[33] R & O at ¶ 794. The source of "permissive authority" to which the Commission refers is Section 254(d) of the Act, 47 U.S.C. § 254(d).